STAFF PAPER

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Project	Accounting Policies and Accounting Estimates
Paper topic	Deletion of IG Example 3 from IAS 8

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Background

1. We are currently drafting the Exposure Draft of amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (ED). During drafting we realised that IG Example 3 *Prospective application of a change in accounting policy when retrospective application is not practicable* is not useful as an illustration of how to distinguish accounting policies and accounting estimates.

2. Appendix A of this paper provides IG Example 3.

Summary of staff recommendation

3. We recommend deleting IG Example 3 from IAS 8.

Staff analysis and recommendation

4. The purpose of IG Example 3 is to illustrate prospective application of a change in accounting policy when retrospective application is not practicable. It was included in IAS 8 (2005) when the Board clarified 'that it is preferable to require prospective application from the start of the earliest period practicable than to permit a change

in accounting policy only when the entity can determine the cumulative effect of the change for all prior periods at the beginning of the current period.'[1]

5. IG Example 3 deals with two simultaneous changes for property, plant and equipment:

   (a) adoption of the revaluation model; and

   (b) applying a component approach more fully for depreciation purposes.

6. The second change relates to a number of things:

   (a) how to identify components; and

   (b) ultimately, how to determine the useful lives of components.

   IG Example 3 states that applying a component approach more fully for depreciation purposes is a change in accounting policy. We believe that this statement raises several questions, such as the following:

   (a) was the failure to apply the component approach 'more fully' in prior years an accounting error?

   (b) did the entity conclude appropriately in prior years that the effect of not applying the components approach 'more fully' was not material?

   (c) did the entity conclude appropriately in prior years that 'more full' application of the components approach would not identify any components with useful lives that differ (to an extent that could have a material effect) from the useful lives of the entire asset?

7. Because IG Example does not address these questions, it risks causing confusion about the distinction between accounting policies and accounting estimates, and possibly about how to identify accounting errors and about materiality. Moreover, we believe that editing the example to address these questions, and perhaps others, would require a substantial rewrite. For the following reasons, we consider that such a rewrite would produce little or no benefit to readers of IAS 8:

[1] Paragraph BC28 of IAS 8.

(a) the example is too specific to a particular fact pattern to be useful as an example of how to make a distinction between an accounting policy and an accounting estimate; and

(b) when retrospective application of a change in accounting policy is not practicable, the mechanics of the required approach are clear from IAS 8 (paragraphs 23-27).

8. Therefore, we recommend that the ED should propose deleting IG Example 3.

9. Please note that IG Example 2 *Change in accounting policy with retrospective application* previously dealt with the accounting policy for capitalisation of borrowing costs. The example was deleted from IAS 8 in 2007 by an amendment to IAS 23 *Borrowing Costs* that deleted a previous option to select an accounting policy of not capitalising borrowing costs. In other words, the Board at the time decided not to replace IG Example 2 with a new fact pattern to demonstrate the mechanics of retrospective application.

Question

Question 1

The staff recommend that the ED should propose deleting IG Example 3 from IAS 8.

Do you agree?

Appendix A

Guidance on implementing IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Example 3 – Prospective application of a change in accounting policy when retrospective application is not practicable

3.1 During 20X2, Delta Co changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.

3.2 In years before 20X2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

3.3 Delta's management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta's new policy prospectively from the start of 20X2.

3.4 Additional information:

Delta's tax rate is 30 per cent.

	CU
Property, plant and equipment at the end of 20X1:	
Cost	25,000
Depreciation	(14,000)
Net book value	11,000
Prospective depreciation expense for 20X2 (old basis)	1,500
Some results of the engineering survey:	
Valuation	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7

Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	2,000

Extract from the notes

1 From the start of 20X2, Delta changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively, from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by CU6,000; increase the opening deferred tax provision by CU1,800; create a revaluation surplus at the start of the year of CU4,200; increase depreciation expense by CU500; and reduce tax expense by CU150.